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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 17.

T. A. MORRISSEY AND JAMES M. O'BRIEN, Trustees of an Express Trust, Known as Western Avenue Golf Club,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

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ALEXANDRIA PRINT SHOP, INC., ALEXANDRIA, VIRGINIA

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Petitioners,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS.

STATEMENT OF THE CASE

This case is before this Court on a writ of certiorari to review a decision of the United States Circuit Court of Appeals for the Ninth Circuit, affirming a decision of the United States Board of Tax Appeals redetermining deficiencies in corporation income tax for the calendar years 1924, 1925 and 1926 in the amounts of $1,890.55, $1,623.49 and $1,036.90.

The petitioners filed income tax returns as trustees as required by Section 219 of the Revenue Act of 1924 (43 Stat. 275), and of the Revenue Act of 1926 (44 Stat. 32). The Commissioner of Internal Revenue determined that the trust constituted an association within the meaning of Section 2 of

the Revenue Act of 1924 (43 Stat. 253), and the Revenue Act of 1926 (44 Stat. 9), and that the petitioners should be taxed at the corporation rate and deductions of amounts distributed to beneficiaries should be disallowed. An appeal was taken to the Board of Tax Appeals and the Commissioner was upheld in his determination that the trust was an association and on review to the United States Circuit Court of Appeals the decision of the Board was affirmed.

This Court granted the writ of certiorari May 13, 1935, to review the decision of the court below.

I.

Opinion of the Court Below.

The opinion of the court below was rendered on January 7, 1935. The opinion has been reported in 74 Fed. (2d) 803 and is a part of the record on this appeal (R. 67-72).

II.

Jurisdiction.

This Court has heretofore granted a writ of certiorari under the Judicial Code, Section 240, as amended by the Act of February 13, 1925 (43 Stat. 938), and Section 1003 (a) of the Revenue Act of 1926 (44 Stat. 110) as amended by Section 603 of the Revenue Act of 1928 (45 Stat. 873) and Section 1101 (a) of the Revenue Act of 1932 (47 Stat. 286) (26 USCA 1224-1226).

III.

Specification of Error

The court below erred in holding that the trustees should be taxed as a corporation and not as a pure trust under Section 219 of the Revenue Acts of 1924 and 1926.

IV.

THE FACTS.

The taxable entity, whether a pure trust or an association, was created October 4, 1921, by a document entitled "Western Avenue Golf Club Declaration of Trust" in which T. A. Morrissey and James M. O'Brien of Los Angeles, California, declared themselves trustees to hold a certain tract of land previously conveyed to them and also any other property to be conveyed to them on terms and conditions stated in the declaration of trust. The declaration of trust is printed in full in the supplemental transcript of record.

The declaration of trust provides that the trustees shall be designated and act in their collective capacity as Western Avenue Golf Club; and that additional trustees shall be selected and vacancies shall be filled by the trustees designated in the instrument and their successors. The two original trustees have acted continuously since the creation of the trust and no additional trustees have been appointed and there have been no vacancies (R. 29).

The powers conferred on the trustees are the usual powers to purchase, hold, improve and manage property. The trustees have authority to adopt rules and regulations, to adopt and use a common seal, to remove trustees (except the original trustees) officers or members of any committee, to appoint an advisory board to be known as directors, to appoint an executive committee, to remove members of advisory board or executive committee or holders of other offices. The instrument provides that the trustees may and the directors and executive committee shall hold meetings in such manner and at such times as the trustees may determine.

The trustees have no power to bind the beneficiaries personally and neither the death of a trustee nor of a beneficiary shall terminate the trust.

The declaration of trust provides that the beneficial shares shall be divided into 2,000 preferred shares of the par value of $100.00, and the common shares of no par value. The preferred shares shall be nonassessable but assessments may be levied on the common shares when deemed necessary or advisable by the trustees.

The instrument expressly provides that the ownership of shares shall not entitle the beneficiary to the right to compel partition and further that neither the declaration of trust nor the ownership of shares shall constitute the parties partners.

The trust is declared to continue for a term of 25 years unless sooner terminated by the trustees.

Provisions are made for the maintenance of books, the amendment of the declaration of trust by the trustees and for the deposit of a duplicate original with the Commissioner of Corporations of the State of California, Sections 857 and 222 of the Civil Code of which State are therein referred to and the provision is made that the rights of all parties and the construction and effect of each and every provision thereof shall be subject to, and construed, according to the laws of that State.

The tract of land which had been previously conveyed to the trustees consisted of 150 acres, 42 acres of which were surveyed and plotted into lots which, beginning December 20, 1921, were sold through a broker. This subdivided property was improved by the construction of streets, sidewalks, and curbs during the year 1922. All of the lots in the 42 acres were sold by the end of 1923. Most of the sales were on installment basis and collections on the sales contracts were made through the collection department of a bank (R. 26, 28).

On the remaining 113 acres, which were not subdivided, a golf course was constructed and completed in September, 1922.

and a club house connected with it was completed in December, 1922.

In July, 1923, the 113 acres comprising the golf course, together with all improvements and equipment, were sold and conveyed to Western Avenue Golf Club, Inc., a California corporation, in exchange for its stock and without other consideration. During the years 1924 and 1925 and 1926, the petitioners received dividends from the said corporation on the stock so acquired in the amounts of $53,560.65, $21,973.60 and $21,973.60.

The petitioners, under a lease from the corporation, continued the operation of the golf course until January 12, 1924. The gross receipts from operations during the 12 days amounted to less than $400.00.

No activities have been engaged in by petitioner between December 31, 1923, and January 1, 1927, except: (1) operation of said golf course for the first 12 days of 1924 as aforesaid, (2) Receipt from collection agent bank of principal and interest so collected by said bank in behalf of petitioner, (3) Receipt of credit of interest earned on bank balances, (4) Receipt of assignment fees in assignment of lot purchase contracts by holders thereof, (5) Conveyance of lots to purchasers thereof, (6) Receipt of dividends from Western Avenue Golf Club, Inc., upon shares thereof owned by petitioner, (7) Distribution of moneys to the holders of beneficial interests in petitioner trust by way of dividends and, in some cases, by way of redemption and retirement of their beneficial interests (R. 28).

The number of beneficial interests issued by the trustees and outstanding during the years in question appear on page 30 of the Transcript of Record. On December 31, 1923, the total number of interests outstanding was 3,016. By December 31, 1926, the interests had gradually decreased to 2,172. The holdings of the trustees ranged from approximately 16 per

cent. to 29 per cent. The number of persons holding beneficial interests on December 31, 1923, was 920, and the number had reduced to 275 by December 31, 1926.

The trustees filed returns and paid the tax at the individual rates.

In the returns the petitioners included in income the dividends received from Western Avenue Golf Club, Inc., and deducted distributions to beneficiaries of the trust in the amounts of $56,829.77, $20,648.00 and $17,511.10 (R. 26).

The respondent determined that the declaration of trust created an association taxable as a corporation, eliminated from income the dividends received from Western Avenue Golf Club, Inc., and denied the deduction of amounts distributed to beneficiaries. An appeal was taken from the deficiencies determined by the respondent to the United States Board of Tax Appeals which held that the trust should be taxed as an association. Review was sought in the Circuit Court of Appeals for the Ninth Circuit which affirmed the decision of the United States Board of Tax Appeals and followed its prior decision in the *Twin Bell Oil Syndicate*, 70 Fed. (2d) 402, which in turn had followed *Security National Bank* v. *Welch*, 54 Fed. (2d) 323, decided by the same court.

V.

THE STATUTES.

Section 219 of the Revenue Acts of 1924 (43 Stat. 275) and 1926 (44 Stat. 32) entitled "Estates and Trusts" provides that the tax imposed on individuals shall apply to the income of property held in trust. Subsection (b) provides that the net income of the trust shall be computed in the same manner as provided in Section 212, with certain exceptions, one of which is that there shall be allowed as a deduction distributions to beneficiaries. Section 219 is in part as follows:

(a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

* * * * * *

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) * * * the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in Section 212, except that—

* * * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *

(3) * * * in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary. * * *

Section 2(a) of the Revenue Act of 1924 (43 Stat. 253) and of the Revenue Act of 1926 (44 Stat. 9) reads in part:

2(a) When used in this Act * * * (2) the term "corporation" includes associations, joint-stock companies, and insurance companies.

Section 704 of the Revenue Act of 1928, (45 Stat. 830) reads:

> (a) If a taxpayer filed a return as a trust for any taxable year prior to the taxable year 1925 such taxpayer shall be taxable as a trust for such year and not as a corporation, if such taxpayer was considered to be taxable as a trust and not as a corporation either (1) under the regulations in force at the time the return was made or at the time of the termination of its existence, or (2) under any ruling of the Commissioner or any duly authorized officer of the Bureau of Internal Revenue applicable to any of such years, and interpretative of any provision of the Revenue Act of 1918, 1921 or 1924, which had not been reversed or revoked prior to the time the return was made, or under any such ruling made after the return was filed which had not been reversed or revoked prior to the time of the termination of the taxpayer's existence.
>
> (b) For the purpose of the Revenue Act of 1926 and prior Revenue Acts, a trust shall, at the option of the trustee exercised within one year after the enactment of this Act, be considered as a trust the income of which is taxable (whether distributed or not) to the beneficiaries, and not as an association; if such trust (1) had a single trustee, and (2) was created and operated for the sole purpose of liquidating real property as a single venture (with such powers of administration as are incidental thereto, including the acquisition, improvement, conservation, division, and sale of such property), distributing the proceeds therefrom in due course to or for the benefit of the beneficiaries, and discharging indebtedness secured by the trust property, and (3) has not made a return for the taxable year as an association.

VI.

THE REGULATIONS.

The years here involved are 1924, 1925 and 1926 for the enforcement of which Treasury Department Regulations 65

and 69 were promulgated. However the statutory provisions relating to and distinguishing associations and trusts are the the same in all acts beginning with that of 1918 and the question arises whether the regulations have the effect of law. It is therefore in order to refer to the pertinent provisions of prior regulations. Article 1502 of Regulations 45 promulgated for the enforcement of the Revenue Act of 1918 (40 Stat. 1057) is:

> Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization.

The above provision was printed without change in Article 1502 of Regulations 62 for the enforcement of the Revenue Act of 1921 (42 Stat. 222) and Regulations 65 for the enforcement of the Revenue Act of 1924 (43 Stat. 253). These Regulations, 62 and 65, do however contain the following additional sentence:

> A corporation which has ceased to exist in contemplation of law but continues its business in corporate form is an association or corporation within the meaning of Section 2, but if it continues its business in the form of a trust, it becomes subject to the provisions of section 219.

Article 1504 of Regulations 45, reprinted without change as Article 1504 of Regulations 62, is:

> Where trustees hold real estate subject to a lease and collect the rents, doing no business other than distributing the income less taxes and similar expenses to the holders

of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, no association exists and the cestuis que trust are liable to tax as beneficiaries of a trust the income of which is to be distributed periodically, whether or not at regular intervals. But in such a trust if the trustees pursuant to the terms thereof have the right to hold the income for future distribution, the net income is taxed to the trustees instead of to the beneficiaries. See Section 219 of the Statute and Articles 341-347. If, however, the cestuis que trust have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the Statute.

On June 7, 1924, subsequent to the Revenue Act of June 2, 1924; the Secretary of the Treasury approved and promulgated Treasury Decision 3598 which was first published June 16, 1924:

"To Collectors of Internal Revenue and others concerned:

In order to give effect to the decision of May 12, 1924, by the United States Supreme Court in the case of *Hecht* v. *Malley* and in the other cases named therein (Nos. 99, 100, 101, and 119—October Term, 1923), Article 7 of Regulations 50 (revised edition, approved June 21, 1920) and Article 8 of Regulations 64 are amended so as to read as follows:

Trusts.—Two distinct classes of trusts are recognized by the Department, namely, holding trusts and operating trusts.

Holding trusts are those in which the trustees are merely holding property for the collection of the income and distributing it among the beneficiaries and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business. Such

trusts are not associations within the meaning of the law and are not subject to the tax.

Operating trusts are those in which the trustees are not restricted to the mere collection of funds and paying them over to the beneficiaries but are associated together in much the same manner as directors in a corporation for the purpose of, and are actually engaged in, carrying on some business enterprise. These trusts, whether of the Massachusetts type or otherwise, are to be deemed associations within the meaning of the Act, independently of any control exercised by the beneficiaries, and subject to the tax."

In Regulations 65 promulgated October 6, 1924, Article 1504 originally read:

> Holding trusts, in which the trustees are merely holding property for the collection of the income and its distribution among the beneficiaries, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, are not associations within the meaning of the law. The trust and the beneficiaries thereof will be subject to tax as provided in articles 341-347. Operating trusts, whether or not of the Massachusetts type, in which the trustees are not restricted to the mere collection of funds and their payments to the beneficiaries, but are associated together in much the same manner as directors in a corporation for the purpose of carrying on some business enterprise, are to be deemed associations within the meaning of the Act, regardless of the control exercised by the beneficiaries.

By Treasury Decision 3749, C. B. IV-2 page 7, published August 31, 1925, Article 1502 of Regulations 65 was amended by causing the last sentence to read:

> A corporation which has ceased to exist in contemplation of law but continues its business in quasi corporate

form is an association or corporation within the meaning of Section 2.

By Treasury Decision 3748 published the same day, C. B. IV-2, page 7, Article 1504 was amended to read:

> Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust although their consent may be required for the filling of a vacancy among the trustees, or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341-347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of Section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

Articles 1502 and 1504 of Regulations 69 promulgated for the enforcement of the Revenue Act of 1926 are the same as Article 1502 and 1504 of Regulations 65 as amended.

Regulations 74 for the enforcement of the Revenue Act of 1928 contains no provision with reference to Section 704 of the Act.

VII.

THE ARGUMENT.

Summary of Argument.

A. In *Crocker* v. *Malley*, 249 U. S. 223, this Court had before it the case of a Massachusetts trust which was not

actively engaged in business and in which the beneficiaries were not associated together in the manner of a corporation and had no control over the trustees. In the case of *Hecht* v. *Malley*, 265 U. S. 144, this Court had before it the case of a Massachusetts trust actively engaged in business after the manner of a corporation and in which the beneficiaries had a voice in the management. In the instant case the trustees were not actively engaged in business after the form and manner of a corporation and the beneficiaries had no voice in the management. The case is therefore distinguishable from *Hecht* v. *Malley*.

B. The word "associations" does not necessarily have its ordinary meaning. The word as used in the Revenue Acts of 1924 and 1926 as well as the prior revenue acts, beginning with that of 1909 is grouped with the words "corporation", "joint-stock companies" and "insurance companies" and appears in entirely different provisions of the several acts from those relating to "estates" and "trusts". The rule of construction to be applied is therefore that the word "associations" includes only such associations as properly are comparable to corporations, joint-stock companies or insurance companies and is to exclude such taxpayers as properly are to be considered estates and trusts. The general rule of construction as applicable here that a word is presumed to have been used in its ordinary sense and meaning is therefore to be considered with and to be modified by the rule that a word is to be construed with reference to the context of the statute in which it appears.

C. The true test to be applied in classifying the trust as an association or as a pure trust is whether or not the trustees acted or carried on business after the form or manner of a corporation. This requires a quasi-corporate organization in which the beneficiaries, whether or not certificate holders, have some voice in the management and some control over the

trustees and have an opportunity to exercise such control through the right to vote at meetings.

D. Even if the so-called business test as applied by the Court below is the paramount test, the mere fact that the trustees under the declaration of trust do some business to the extent of retaining title to and collecting and distributing the income from the land and the shares of corporate stock placed in trust does not require that the trust be taxed as a corporation. In these meager activities the trustees were not acting or carrying on business as contemplated by this Court in *Hecht* v. *Malley*.

E. The activities actually engaged in by the trustees, rather than the possible activities authorized by the declaration of trust, are to be considered in determining whether or not they were acting or carrying on business in the form and manner of a corporation.

F. The provisions of the Revenue Act of 1924 are to be construed as adopting and approving the Treasury Department Regulations promulgated under previous laws and in force at the time of the enactment of the Revenue Act of 1924 and therefore the trustees are to be taxed as a pure trust for the year 1924 for the reason that under the adopted regulations they should not be considered an association. The regulations became law on the reenactment without change of the provisions of the previous statutes. The regulations had not been materially changed at the time of the enactment of the Revenue Act of 1926.

G. Pursuant to the retroactive provisions of Section 704 of the Revenue Act of 1928 the trustees are taxable as a trust because they filed a return as a trust and were considered to be taxable as a trust under regulations in force at the time the return was made. The section by its express terms embraces all years prior to 1925.

POINT A.

Hecht v. Malley is Distinguishable from Crocker v. Malley and the Instant Case.

In the case of *Crocker* v. *Malley*, 249 U. S. 223, this Court had before it the provision of the Act of October 3, 1913, (38 Stat. 177) which imposed a tax on the income of "every corporation, joint-stock company or association." The taxpayer was a real estate trust of the kind known as a "Massachusetts trust" in which the certificate holders were in no way associated together, no provision was made for meetings and they had no control over the trustees. In that case this Court held that the declaration of trusts did not create an association within the meaning of the provision of the Act of 1913 imposing the tax on an association. The Act of October 3, 1913, levied a tax on incomes and in *Brushaber* v. *Union Pacific*, 240 U. S. 1, this Court held the act was constitutional as not repugnant to the Fifth Amendment and not inconsistent with the Sixteenth Amendment of the Constitution.

The petitioners submit that in the case of *Crocker* v. *Malley* this Court had before it the provisions of an act levying an income tax and in which Congress imposed the tax on individuals as well as corporations. In other words, for the purpose of the imposition of the income tax, Congress has consistently classified taxpayers as individuals and as corporations, and a pure trust is taxable as an individual and an association as a corporation. The question here involved is simply that of the proper classification of the taxable entity, as an individual or as a corporation. There is present no question of escaping tax liability as in *Hecht* v. *Malley*, below. Under the question is that of double tax liability as in *Crocker* v. *Malley*.

Before passing on from the case of *Crocker* v. *Malley*, the Court's attention is invited to the similarity of the facts in that

case and in the instant case. In both cases, there was an ordinary real estate trust, the beneficiaries had no voice in the management and in neither case did the trust bear any resemblance to a corporation.

In the case of *Hecht* v. *Malley*, 265 U. S. 144, decided by this Court May 12, 1924, the tax involved was not the income tax but the capital stock tax, an excise tax levied on corporations but not on individuals. The case did not involve the classification of a taxpayer as an individual or as a corporation. Among the cases there before this Court was the Crocker trust which was the petitioner in *Crocker* v. *Malley, supra,* but the terms of the trust instrument had been amended and the trustees had greatly increased their activities. The specific provision of law there before this Court was Section 407 of the Revenue Act of September 8, 1916, (39 Stat. 756) and Section 1000 of the Revenue Act of 1918, Act of February 24, 1919, (40 Stat. 1057) in which the capital stock tax was imposed on "every corporation, joint-stock company or association." The tax imposed was, however, the special excise tax, the imposition of which has been held to be constitutional only when imposed on the privilege of doing business. *Ray Consolidated Copper Company*, 268 U. S. 273. In the case of *Hecht* v. *Malley, supra,* which involved the capital stock tax, this Court had before it as one of the bases for the imposition of tax the question of the carrying on or doing business which was not before this Court in the previous case of *Crocker* v. *Malley, supra.*

In the opinion of Mr. Justice Sanford in the case of *Hecht* v. *Malley,* that and the *Crocker* v. *Malley* cases are distinguished with the following explanations:

> The trustees of the Hecht and Hay-Market Trust earnestly rely, however, upon the decision in *Crocker* v. *Malley*, 249 U. S. 223, 63 L. ed. 573, 2 A. L. R. 1601, 39 Sup.

Ct. Rep. 270, as conclusively determining that they cannot be held to be "associations" unless the trust agreements vest the shareholders with such control over the trustees as to constitute them more than strict trusts within the Massachusetts rule. This case arose under No. II. G(a), of the Income Tax Act of October 3, 1913, imposing a tax upon the net income of 'every corporation, joint-stock company or association * * * organized in the United States, no matter how created or organized." (38 Stat. at L. 172, chap. 16, 4 Fed. Stat. Anno. 2d ed. p. 245.) Section II.D provided that trustees or other fiduciaries were exempt from this tax upon dividends received from corporations taxable upon their net income. The precise question was whether the trustees of the Wachusett Realty Trust were subject to the income tax upon dividends received from a Massachusetts corporation that was itself taxable upon its net income. The trustees insisted that they were not an "association" subject to this tax, under G(a), but merely trustees, and entitled to the exemption as fiduciaries under D. The trust had been created by a Maine corporation which contemplated dissolution, for the benefit of its shareholders. It had transferred to the trustees the fee of certain lands leased to a Massachusetts manufacturing corporation engaged in operating several mills, and also the stock in that corporation which it held. The purpose of the trust was to convert this property into money and distribute the net proceeds to the beneficiaries, within a period left to the discretion of the trustees. Meanwhile they were to distribute the net income, but could apply any funds for the repair and development of the property or the acquisition of other property, pending conversion and distribution. Their function, as emphasized in the opinion, was not to manage the mills, but simply to collect the rents and income, with a large discretion in its application. The beneficiaries had no control except in certain matters in which their consent was required.

The Court, after stating that the declaration of trust on its face was "an ordinary real estate trust of the kind

familiar in Massachusetts," and that there "could be little doubt that in Massachusetts this arrangement would be held to create a trust and nothing more," said that "as the plaintiffs undeniably are trustees; if they are to be subjected to a double liability the language of the statute must make the intention clear;" and that "it would be a wide departure from a normal usage to call the beneficiaries here a joint-stock association when they are admitted not to be partners in any sense, and when they have no joint action or interest and no control over the fund. On the other hand, the trustees by themselves cannot be a joint-stock association within the meaning of the act unless all the trustees with discretionary powers are such, and the special provision for trustees in D is to be made meaningless. We perceive no ground for grouping the two—beneficiaries and trustees—together, in order to turn them into an association, by uniting their contrasted functions and powers, although they are in no proper sense associated. * * * We presume that the taxation of corporations and joint-stock companies upon dividends of corporations that themselves pay the income tax was for the purpose of discouraging combinations of the kind now in disfavor, by which a corporation holds controlling interests in other corporations which, in their turn, may control others, and so on, and in this way concentrates a power that is disapproved. There is nothing of that sort here. Upon the whole case we are of opinion that the statute fails to show a clear intent to subject the dividends on the Massachusetts corporation's stock to the extra tax imposed by G(a)."

This opinion is based primarily upon the view that the Income Tax Act, considering its purpose, did not show a clear intention to impose upon the trustees, as an "association," a double liability in reference to the dividends on stock in the corporation that itself paid an income tax, when, considered as "trustees," they were, by another provision of the act, exempt from such payment. And the language used arguendo in reaching this conclusion that the trustees could not be deemed an association unless all trustees with discretionary powers are such, and that

there was no ground for grouping together the beneficiaries and trustees in order to turn them into an association, is to be read in the light of the trust agreement there involved, under which the trustees were, in substance, merely holding property for the collection of the income and its distribution among the beneficiaries, and were not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business. *Zonne* v. *Minneapolis Syndicate*, 220 U. S. 187, 190, 55 L. ed. 428, 430, 31 Sup. ct. Rep. 361. And see *Smith* v. *Anderson*, L. R. 15 Ch. Div. 247, 50 L. J. Ch. N. S. 39, 43 L. T. N. S. 329, 29 Week Rep. 21.

It results that *Crocker* v. *Malley is not an authority for* the broad proposition that, under an act imposing an excise tax upon the privilege of carrying on a business, a Massachusetts trust engaged in the carrying on of business in a quasi corporate form, in which the trustees have similar or greater powers than the directors in a corporation, is not an "association" within the meaning of its provisions.

We conclude, therefore, that when the nature of the three trusts here involved is considered, as the petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be deemed associations within the meaning of the Act of 1918; this being true independently of the large measure of control exercised by the beneficiaries in the Hecht and Haymarket Cases, which much exceeds that exercised by the beneficiaries under the Wachusett Trust. We do not believe that it was intended that organizations of this character—described as "associations" by the Massachusetts Statutes, and subject to duties and liabilities as such—should be exempt from the excise tax on the privilege of carrying on their business merely because such a slight measure of control may be vested in the beneficiaries that they might be deemed strict trusts within the rule established by the Massachusetts Courts.

The petitioners submit that the instant case is readily distinguishable from *Hecht* v. *Malley, supra,* on the following grounds:

1. The trustees were not actually engaged in carrying on a business in a quasi corporate form. On the contrary they were merely conserving the corpus of the trust and collecting and distributing income.

2. The trustees were not associated together with similar or greater powers than the directors of a corporation. The powers of the trustees were those usual in a pure trust.

3. The certificate holders had no voice in the management and no meetings were provided for. This distinguishes the instant case from *Hecht* v. *Malley* and places it in the same class as *Crocker* v. *Malley*.

4. The provisions of the Act before this Court in *Hecht* v. *Malley* had not been made the subject of regulations by the Treasury Department. In the instant case the regulations under previous acts are to be considered as law.

5. There is the further distinction that in the case of *Hecht* v. *Malley* the tax involved was an excise tax on carrying on or doing business, while in the instant case the tax is the income tax and the question is not that of tax exemption in any sense but merely that of the classification of the taxpayer as an individual or a corporation.

The most recent decision of this Court having any bearing on the question here involved appears to be *Senior* v. *Braden*, decided May 20, 1935, 79 L. ed. 863, which involved a taxing act of the State of Ohio. In his opinion Mr. Justice McReynolds refers to *Hecht* v. *Malley, supra,* as authority that a test for classifying a trust as an association is the voice of the beneficiaries in the management. The following is quoted from the opinion in that case:

Each trustee holds only one piece of land and is free from control by the beneficiaries. They are not joined with it in management.

The petitioners submit that the facts in the instant and those in *Crocker* v. *Malley, supra,* are similar and that the question is the same and that the decision of this Court in that case is controlling.

POINT B.

The Word "Associations" in the Several Revenue Acts is Grouped With the Terms "Joint-Stock Companies" and "Insurance Companies" and is to be Construed to Include Only Such Associations as are Properly Comparable to Corporations, Joint-Stock Companies or Insurance Companies. The Applicable Rule of Statutory Construction is that the Term is to be Construed with Reference to the Context of the Statutory Provision in which it Appears.

This Court in *Hecht* v. *Malley, supra,* stated that the word "association" appears to be used, in the act there under consideration, in its ordinary meaning and the Court referred to definitions previously given the term. In the course of his opinion, Mr. Justice Sanford stated:

> It has been defined as a term "used throughout the United States to signify a body of persons united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise." 1 Abbott's Law Dict. 101 (1879); I Bouvier's Law Dict. Rawle's 3d Rev. p. 269; 3 Am. & Eng. Enc. Law, 2d ed. 162; and *Allen* v. *Stevens,* 33 App. Div. 485, 54 N. Y. Supp. 8, 23, in which this definition was cited with approval as being in accord with the common understanding. Other definitions are: "In the United States, as distinguished from a corporation, a body of persons organized for the prosecution of some purpose, without a charter, but having the general form and mode of procedure of a corporation." Webster's New Int. Dict. "(U. S.) An organized but unchartered body analogous

> to, but distinguished from, a corporation." Pract. Stand. Dict. * * *
>
> We think that the word "association," as used in the act, clearly includes "Massachusetts trusts" such as those herein involved, having quasi corporate organizations under which they are engaged in carrying on business enterprises. What other form of "associations," if any, it includes, we need not, and do not, determine.

It is to be noted that in both the definitions quoted and in this Court's own definition that an association is a quasi corporation or has the general form and mode of procedure of a corporation.

The word "associations" appears in Section 2 of both the Revenue Acts of 1924 and 1926. In both acts this section is in part:

> When used in this Act—
>
> (1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.
>
> (2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

Embraced in the definition of the term "person" and as separate and distinct taxpayers are trusts and corporations. Trusts are taxable as individuals under Section 219 of each Act and corporations are subject to a different tax under Section 230 of each Act.

In addition to being included in the definition of "corporation" the term "associations" is grouped with the terms "joint-stock companies" and "insurance companies". By the use of the term "associations" Congress meant something comparable to a joint-stock company or an insurance company, certainly something in the nature of a company. There is today but little difference between a joint-stock company and a corporation and it is not improper to call such company a quasi corporation, 33 C. J. 879. In using the term "insurance com-

panies" Congress clearly meant corporation engaged in the business of insuring.

The rule of construction that should be followed here is therefore that the word "associations" should be held to mean such taxpayers as are comparable to "joint-stock companies" and "insurance companies".

We are here concerned with "property held in trust" within the express provisions of Section 219 of both the 1924 and 1926 Acts entitled "Estates and Trusts". Equally with the provisions of Section 2 in which associations are classed as corporations the petitioners submit force should be given to Section 219 under the general language of which the trust here involved necessarily falls because property is held in trust and this Court must find that the trust comes clearly within the intendment of Section 2 before the petitioners can be excluded from the terms of Section 219 and taxed as an association or corporation under Section 230. As stated in *Coleman-Gilbert Associates* v. *Commissioner*, 76 Fed. (2d) 191, 195:

> The imposition of a double tax upon the income of the trust as an entity, and a further tax upon the distributive shares of the beneficiaries, should clearly be warranted under the acts of Congress, and should not have as its basis some remote resemblance to a corporation. If there is doubt, it should be resolved in favor of the taxpayer. Citing *Crocker* v. *Malley* and *Hecht* v. *Malley*.

POINT C.

The True Test to be Applied is Whether the Trustees Act or Carry on Business After the Form and Manner of a Corporation. This Requires a Quasi-Corporate Corporation in Which the Beneficiaries Have Some Voice in the Management.

As pointed out in *Coleman-Gilbert Associates* v. *Commissioner*, 76 Fed. (2) 191, First Circuit, Congress has not under-

taken to lay down any tests for determining whether an organization is an association or a pure trust.

> "As yet the Supreme Court has not laid down any absolute tests. * * * The Treasury Department has endeavored from time to time to clarify the situation by regulations defining associations and trusts. * * *
>
> "We think, however, it is generally agreed that, in order for a trust to be taxed as a corporation, the trustees must not only be carrying on a business enterprise for profit, but must be doing it in much the same manner and form as directors of a corporation. One other factor also seems to be agreed upon: that it is not what the trustees are authorized to do under the trust instrument, but what they actually are doing. *Gardiner* v. *United States*, 49 Fed. (2d) 992; *Commissioner* v. *Pryor & Lockhart Development Co.*, (70 Fed. (2d) 154)."

In *Hecht* v. *Malley, supra*, this Court gives as its definition of an association a quasi-corporate organization.

The Board of Tax Appeals, following the rule laid down in *Sturgeon* v. *Commissioner*, 25 B. T. A. 368, has consistently stated as a requirement for an association that the beneficiaries shall have associated themselves in the general form and manner of procedure of a corporation.

The petitioners are trustees "of property held in trust" within the exact wording of Section 219 and are not to be compared with the directors of a quasi-corporation, and they are not engaged in doing business in the form or mode of procedure of a corporation. Under the test laid down by the Board itself; the trustees should not be taxed as a corporation but as a pure trust.

The Board held that for the year 1923 the petitioners are taxable as a trust, and the petitioners submit that the provisions of several revenue acts are identical and that the same

tests should be applied to the years 1924, 1925 and 1926 that were applied to the year 1923, and the decision should be that the declaration did not create a quasi-corporate organization, that the trustees did not act in the form and mode of procedure of a corporation and that the beneficiaries had no voice in the conduct of the business.

The instant case differs necessarily from cases in which persons are associated together for the purpose of manufacturing or merchandising in which the primary object is to do business rather than to hold property. In the case, *Reinecke* v. *Kaenpfer*, 72 Fed. (2d) 469, the trustees were associated to carry on the business of selling bird seed. The purpose of the association was necessarily the merchandising of bird seed. The trustees were held taxable as an association following *Hecht* v. *Malley, supra,* on the ground that the petitioners were not merely trustees for collecting funds and paying them over, but were associated in much the same manner as directors in a corporation for the purpose of carrying on a business enterprise. In the instant case, the purpose of the trust is not to engage in a manufacturing or merchandising business or to associate the various interested persons as a company for the conduct of business, but is merely to place the title to a certain tract of real estate in trustees to be disposed of by them and the venture concluded.

The test which in certain cases has been followed by the Board of Tax Appeals is that stated in *Sturgeon* v. *Commissioner*, 25 B. T. A., 368, 374:

> This Board has held that the significant tests to be applied in determining whether an alleged trust is a trust, or an association taxable as a corporation, are whether (1) the beneficiaries of the alleged trust have voluntarily associated themselves together in the general form and mode of procedure of a corporation, and (2) are organized to, and in fact, are engaged in the active conduct of

> a business for profit, or (3) whether the trustees are merely holding the property and collecting the income therefrom and distributing to those beneficially interested. *Extension Oil Co.*, 16 B. T. A. 1028; affd., 47 Fed. (2d) 65; *Jackson-Wermich Trust*, 24 B. T. A. 150; *E. B. Galbreath et al.*, 24 B. T. A. 1107.

In the instant case the Board did, however, apparently not so much heed its own tests as it did the decision of the Circuit Court of Appeals for the Ninth Circuit, by which its decision was reviewable, in the case of *Sloan* v. *Commissioner*, 63 Fed. (2d) 666. In that case, as in this, the petitioners submit, the Court went far beyond the terms of the revenue act and the provisions of the regulations in holding that trustees, engaged merely in collecting and distributing installment payments, were doing business in the form and manner of a corporation. As stated in *Commissioner* v. *Kelley*, 74 Fed. (2d) 71, 74:

> there is no law prohibiting trustees from carrying on business for profit; but if the trustees are given absolute control over the business and the cestuis qui trustent have no control, either over the trustees or the business, such a trust is not taxable as a corporation.

In *Bouchard* v. *First People's Trust*, 253 Mass. 351, it was held that the trust was not an "association" within the meaning of G. L. c. 182, Sec. 6, permitting a suit against an association for acts of trustees and the Court said at pages 360-361:

> "It seems plain to us that there is no association, in the sense in which that word is commonly used, among the shareholders of the First People's Trust. Each of them has simply a property interest in a fund held for their common benefit. The arrangement established by the declaration of trust involves a total want of legal power by the shareholders as to the trust. They have no voice direct or remote in its management. They cannot exercise the slightest control over the selection or conduct of the trus-

tees. No question as to its execution can be ever submitted to them for approval or even for advice. Each shareholder by subscribing for a certificate, which is by individual choice and not by joint action, surrenders to those, who are and from time to time become trustees by the self-perpetuating selection of the trustees for the time being, all legal power over the money paid for the subscription. The shareholders are unassociated; they have no organization; each of them has simply an equitable interest in the trust. The various definitions of the word 'association' all imply, if they do not require, as an essential element, that there be some form of organization resembling modes of procedure inherent in incorporated bodies. A business corporation is unthinkable where the shareholders are devoid of legal rights, have no officers and are and must remain forever dumb as to the selection, approval or disapproval of managers and methods of conduct of corporate affairs."

POINT D.

The Mere Fact that the Trustees Retained Title to Land and Shares of Corporate Stock and Collected and Distributed Income Does Not Amount to Doing Business as Contemplated by This Court in Hecht v. Malley.

The Court below, following its previous decisions, applied what it termed the business test and held that the meager activities of the trustees constituted doing business and hence the trustees are to be taxed as an association. In the opinion it is stated:

> As to the contention that "doing business" is not controlling or relevant, this court in *Twin Bell Oil Syndicate* v. *Helvering*, 70 F. (2d) 402 (C. C. A. 9), after quoting from its opinion in the *Trust No. 5833, Security First National Bank* v. *Welch*, 54 F. (2d) 323 (C. C. A. 9), said at page 407:
>
> > "There is ample additional authority for the proposition that the 'business' test is now paramount."

This Court has not held that business activity alone is sufficient to require that a trust be classified as an association. In *Hecht* v. *Malley, supra,* this Court clearly pointed out that the organizations there under consideration were not merely doing business but the doing of business was after the form and methods of a corporation. The petitioners submit that there is a wide distinction between mere business activity and the conduct of business after the form and manner of a corporation. Business is conducted by individuals and partnerships as well as by corporations. The mere act of doing business or the mere fact that some business is done is not the sole test. The business activity is looked to merely for the purpose of determining the manner in which done. The test is, therefore, the manner of doing business and not the fact of doing business.

In the present case, the trustees were merely holding title to property and as necessary incidents thereto were receiving the purchase price for property previously sold and income and dividends and were distributing money so received to beneficiaries. These activities are such as are necessarily incident to the ownership of property and bear no resemblance to the conduct of business in the form and manner of a corporation.

What constitutes carrying on or doing business is, of course, difficult to define, but the question has been considered by a number of the lower courts in connection with the capital stock tax, which to be constitutional requires that the taxpayer be carrying on or doing business. The courts have consistently held that a taxpayer, whether or not a corporation, whose activities are confined to the preservation of property and the collection and distribution of income, are not carrying on or doing business and not subject to the capital stock tax. See *Fink Coal and Coke Company* v. *Heiner,* 26 Fed. (2d) 136; *Lane Timber Company* v. *Hynson,* 4 Fed. (2d) 666; *Cannon*

v. *Elk Creek Lumber Company*, 8 Fed. (2d) 996 and *Clallon Lumber Company* v. *United States* (D. C.) 34 Fed. (2d) 994.

POINT E.

The Activities Actually Engaged in by the Trustees, Rather Than the Possible Activities Authorized by the Declaration of Trust, are to be Considered in Determining Whether or not they were Acting or Carrying on Business in the Form and Manner of a Corporation.

There is apparent unanimity of decision that in determining the classification of a trust as a pure trust or as an association the actual activities of the trustees are to be looked to rather than those authorized by the trust instrument but not exercised by the trustees. See *Commissioner* v. *Brouillard*, 70 Fed. (2d) 54, Tenth Circuit; *Tyson* v. *Commissioner*, 54 Fed. (2d) 29, Seventh Circuit; *Commissioner* v. *Duckwitz*, 68 Fed. (2d) 629, Seventh Circuit; *Dunbar* v. *Commissioner*, 65 Fed. (2d) 447, First Circuit and *Gardiner* v. *U. S.*, 49 Fed. (2d) 992, First Circuit. In the last mentioned case it is stated, "The crucial test must be found in what the trustees actually do, not in the mere existence of long unused broad powers."

The record clearly sets forth the activities actually engaged in by the trustees which, except for the insignificant period of twelve days, consisted simply in the retention of title to property, the principal part of which had previously been disposed of under sales contracts, the collection of the sales price and the formal conveyance of title, the collection of income and the distribution of both the purchase price and the income to the beneficiaries of the trust. These activities appear in the record as follows:

> (1) operation of said golf course for the first 12 days of 1924 as aforesaid, (2) Receipt from collection agent bank of principal and interest so collected by said bank in behalf

of petitioner, (3) Receipt of credit of interest earned on bank balances, (4) Receipt of assignment fees in assignment of lot purchase contracts by holders thereof, (6) Receipt of dividends from Western Avenue Golf Club, Inc., upon shares thereof owned by petitioner, (7) Distribution of moneys to holders of beneficial interests in petitioner trust by way of dividends and, in some cases, by way of redemption and retirement of their beneficial interests.

It is to be remembered that all real estate had been sold or agreed to be sold, that the stock holdings were acquired in exchange for a part of the land and that all that the trustees were in fact doing was collecting the income and distributing it. Under the provisions of Article 1504, as variously amended, of Regulations 45, 62, 65 and 69, the trust should be classed as a holding trust or as one merely holding property for the collection and distribution of income with ultimate liquidation in view on the termination of a single venture.

POINT F.

The Provisions of the Revenue Act of 1924 are to be Construed as Incorporating Previous Treasury Department Regulations in Force at the Time the Provisions of Existing Laws were Re-enacted, and for that Year there is no Doubt but that the Trustees are to be Taxed as a Pure Trust. At the Time of the Enactment of the Revenue Act of 1926, the Regulations had not been Materially Changed, and Thereunder the Trustees Should be Taxed as a Pure Trust.

The years here involved are 1924, the tax for which is imposed by the Revenue Act of 1924, and 1925 and 1926, the tax for which is imposed by the Revenue Act of 1926. The provisions relating to associations and trusts in these acts as well as in the Revenue Act of 1918 (40 Stat. 1057) and in the Revenue Act of 1921 (42 Stat. 222) are identical. The pro-

visions of these earlier acts have, therefore, been reenacted without change, and such regulations as were promulgated for the enforcement of the Revenue Act of 1918 and the Revenue Act of 1921 and which were in force at the time of the enactment of the Revenue Act of 1924 and the Revenue Act of 1926 have, therefore, the force and effect of law.

In each of the revenue acts, provision is made for the promulgation of regulations by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury. This provision is, of course, to be construed to mean that the Commissioner has authority to promulgate merely such rules and regulations as are administratively necessary. The Commissioner, of course, does not have authority in any way to alter the provisions of the current act. Further, his interpretation of the current act is not in any sense binding on the courts.

But when the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury has promulgated regulations for the enforcement of the revenue act, or acts, and has consistently applied his regulations, and then Congress reenacts the same statutory provisions, the rule of statutory construction, binding on the courts, is that Congress by reenacting the statute without change adopts the administrative construction in the regulations and those regulations become law.

In Regulations 45, promulgated under the Revenue Act of 1918, the Treasury Department in Articles 1502 and 1504 undertook to define an association or to prescribe tests for the determination of what constitutes an association and also to distinguish an association from a pure trust. Article 1502 provides that associations include trusts and organizations which act or do business in an organized capacity and the income of which is distributed or distributable among members.

This article of the regulations applies as the test the acting or doing business in an organized capacity: This test is so general as to be of but little help. This article of the regulations has been promulgated without material change in all subsequent regulations. The change made in Article 1502 of Regulations 62 is that a corporation which has ceased to exist in law but continues its business in corporate form; it is taxable as an association, but if it continues its business as a trust, it is subject to the provisions of section 219. This was repeated in Regulations 65. This added provision in Regulation 62 sets forth the clearest possible distinction between an association and a trust. The exact words of the Regulations are:

> A corporation which has ceased to exist in contemplation of law but continues its business in corporate form is an association or corporation within the meaning of Section 2, but if it continues its business in the form of a trust, it becomes subject to the provisions of Section 219.

In reenacting Section 2 of the Revenue Act of 1921 without change, Congress incorporated and read into the Revenue Act of 1924 this distinction between an association and a pure trust, that an association "continues its business in corporate form" and a pure trust "continues its business in the form of a trust."

Article 1504 of Regulations 45 provides that if the cestuis que trusts have a voice in the conduct of the business, a commonlaw trust is an association.

Regulations 62, promulgated for the Revenue Act of 1921, reprinted without change the above provision of Regulations 45.

The regulations in force at the time of the enactment of the Revenue Act of 1924 were, therefore, Regulations 45 and Regulations 62, and when Congress reenacted in the Revenue Act of 1924 the provision of the Revenue Act of 1918 and the Revenue Act of 1921, that the term "corporation" includes

an association, it approved and adopted the construction placed on that provision in the prior regulations. Article 1504 of both regulations is:

> Where trustees hold real estate subject to a lease and collect the rents, doing no business other than distributing the income less taxes and similar expenses to the holders of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, no association exists and the cestuis que trust are liable to tax as beneficiaries of a trust, the income of which is to be distributed periodically, whether or not at regular intervals. But in such a trust if the trustees pursuant to the terms thereof have the right to hold the income for future distribution, the net income is taxed to the trustees instead of to the beneficiaries. See Section 219 of the statute and Articles 341-347. If, however, the cestuis que trust have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute.

It is, therefore, submitted that insofar as the Revenue Act of 1924 is concerned, its provisions must be given the same construction that the regulations and the Commissioner's rulings had been given to the prior acts.

When the Commissioner came to promulgate rulings for the enforcement of the Revenue Act of 1924, he made a change in Article 1504 and attempted to distinguish between holding trusts and operating trusts. It is submitted, however, that the regulations made after the enactment of the Revenue Act of 1924 cannot be looked to find the intent of Congress in the interpretation of the act and are in no sense binding on the courts. The point the petitioners desire to make is that a regulation pertaining to a prior law, reenacted without change,

has the approval of Congress and has the effect of law, but that a regulation subsequently promulgated does not.

When we come to the year 1925 and 1926 and to the construction of the Revenue Act of 1926, consideration must, of course, be given to the changes in the regulations, if any. In Regulations 65, for the enforcement of the Revenue Act of 1924, promulgated October 6, 1924, Article 1502 was printed without material change, but Article 1504 was changed to distinguish between holding trusts and operating trusts. By Treasury Decision 3748 and on August 31, 1925, the regulation was amended to define as a pure trust the holding of property by the trustees without control by the beneficiaries and to define as an association a trust in which the beneficiaries have positive control, and further the regulations stated that even in the absence of control by the beneficiaries where the trustees are not restricted to the collection and distribution of income but are associated together with similar powers to the directors of a corporation for the purpose of carrying on a business enterprise, the trust should be classed as an association. Article 1504 of Regulations 65 as so amended reads:

> Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by Section 219 and by Articles 341-347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of Section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the

> mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

This was the state of the regulations at the time of the enactment of the Revenue Act of 1926, and it is submitted that these changes were known to Congress and should, of course, be resorted to in the construction of the Revenue Act of 1926, if these changes are in fact material. It is, therefore, in order to read Treasury Decision 3748 in conjunction with Section 2(a) of the Revenue Act of 1926 (44 Stat. 9).

The trustees in the instant case were merely holding property "for the collection of the income and its distribution among the beneficiaries of the trust" and were not engaged "in the carrying on of any business" and the beneficiaries had no control over the trust within the exact wording of Article 1504 of Regulations 65, as amended by Treasury Decision 3748, in force at the time of the enactment of the Revenue Act of 1926. As a matter of fact the trustees are taxable as a pure trust within the express terms of Article 1504 of Regulations 69 promulgated for the enforcement of the Revenue Act of 1926 and which article is the same as Treasury Decision 3748.

POINT G.

Pursuant to the Retroactive Provisions of Section 704 of the Revenue Act of 1928, the Trustees are Taxable as a Trust Because they Filed a Return as a Trust and were Considered to be Taxable as a Trust Under Regulations in Force at the Time the Return was Made. The Section by its Express Terms Embraces all Years Prior to 1925.

In Section 704 of the Revenue Act of 1928, (45 Stat. 880) which is retroactive, provision is made that for years prior to

1925 a taxpayer shall be taxable as a pure trust and not as a corporation if the taxpayer was considered to be taxable as a trust and not as a corporation under the regulations in force at the time the return was made. Section 704 is, therefore, to be read as a part of the Revenue Act of 1924. Section 704 in part is:

> (a) If a taxpayer filed a return as a trust for any taxable year prior to the taxable year 1925 such taxpayer shall be taxable as a trust for such year and not as a corporation, if such taxpayer was considered to be taxable as a trust and not as a corporation either (1) under the regulations in force at the time the return was made or at the time of the termination of its existence, or (2) under any ruling of the Commissioner or any duly authorized officer of the Bureau of Internal Revenue applicable to any of such years, and interpretative of any provision of the Revenue Act of 1918, 1921 or 1924, which had not been reversed or revoked prior to the time the return was made, or under any such ruling made after the return was filed which had not been reversed or revoked prior to the time of the termination of the taxpayer's existence.

The position of the petitioners is that under the regulations in force at the time the return for 1924 was filed, the petitioners should be classed as a pure trust and not as a corporation, this for the two reasons (1) that the regulations in force at the time of its passage are part of the act and (2) that Section 704 of the Revenue Act of 1928 so provides.

The Board of Tax Appeals held that pursuant to the provisions of Section 704 of the Revenue Act of 1928 and of the appropriate regulations in existence at the time the return was filed that the petitioners are taxable as a pure trust for 1923, but for the year 1924 the Board held that the petitioners are taxable as a corporation. The reasoning of the Board appears to be that a change in regulations dated from May 12,

1924, when this Court handed down the decision in *Hecht* v. *Malley, suprd.* The Board used as the basic date the date of the decision of this Court rather than August 31, 1925, when Regulations 65, Article 1504 were amended to give effect to what the Treasury Department considered to be the proper application of the decision of this court in an income tax case. In its opinion, the Board stated:

> We have heretofore held in applying this section of the Act that under the Commissioner's Regulations and Bureau Rulings, in effect up to and including the calendar year 1923, and prior to the change in the Commissioner's Rulings giving effect to the decision in *Hecht* v. *Malley*, 265 U. S. 144, decided May 12, 1924, the test to be applied in distinguishing trusts from associations was whether the beneficiaries or shareholders controlled the action of the trustees.

The reasoning of the Board is that the regulations were changed immediately on the rendition of the decision of this Court in the case of *Hecht* v. *Malley* on May 12, 1924, while as a matter of fact, the actual amendment to the regulations was not promulgated until August 31, 1925, and after the petitioners had filed the return for the year 1924.

It is, therefore, the position of the petitioners that the Board of Tax Appeals has placed an erroneous construction on Section 704 of the Revenue Act of 1928. We are here concerned with the construction of the provision of the Act of 1928 as well as of the provisions of the Act of 1924. The specific provision of Section 704 is that a taxpayer shall be taxable as a trust if under "the regulations in force at the time the return was made" the taxpayer was taxable as a pure trust and not as a corporation.

In Section 704, no reference is made to the decisions of the courts.

The regulations which were in force at the time the return was filed are, therefore, those contained in Article 1504 of Regulations 65 in which trusts are classified as holding trusts and operating trusts and in which holding trusts are referred to as those in which the trustees merely hold property for the collection and disbursement of income and in which operating trusts are referred to as those in which the trustees are not merely engaged in the collection and distribution of income but are associated together in much the same manner as directors in a corporation for the purpose of carrying on some business enterprise.

Under this provision of the regulations it is respectfully submitted that the petitioners should be taxed as a pure trust for the year 1924, for Congress has very clearly indicated in the reference to years prior to 1925 that a trust, such as the one here under consideration, should under all regulations prior to August 31, 1925, be taxed as a pure trust and not as an association.

VIII.

CONCLUSION.

The petitioners submit that they are, within the meaning of Section 219 of the Revenue Acts of 1924 and 1926, trustees "of property held in trust" consisting of that part of the land originally placed in trust which finally had not been disposed of and of the shares of corporate stock received in exchange for another part of the real estate and that they should be taxed as a trust and not as an association for the reason that the petitioners were simply holding title to the land and the shares of corporate stock and collecting and distributing the avails thereof to the beneficiaries of the trust. They were not carrying on or doing business after the form or manner of a corporation and they were not acting in the manner of a board

of directors and the beneficiaries had no voice in the management of the trust as do stockholders in a corporation.

The petitioners further submit that for the year 1924 they should be taxed as a trust under both the regulations in force at the time of the enactment of the Revenue Act of 1924 and under the express provisions of Section 704 of the Revenue Act of 1928.

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